INDEX.

Page

PETITION FOR WRIT OF CERTIORARI 1

SUMMARY STATEMENT OF MATTER INVOLVED 1

REASONS RELIED UPON FOR ALLOWANCE OF WRIT 5

BRIEF IN SUPPORT OF PETITION 7

I. OPINION OF CIRCUIT COURT 7

II. GROUNDS OF JURISDICTION 7

(A) JURISDICTIONAL STATUTES 7

(B) STATUTES INVOLVED 7

REGULATIONS INVOLVED 8

(C) DATE OF JUDGMENT 8

III. CONCISE STATEMENT OF CASE 8

IV. ASSIGNMENT OF ERRORS 9

V. ARGUMENT 9

FIRST, SECOND AND THIRD ASSIGNMENTS 9

FOURTH ASSIGNMENT 14

TABLE OF CASES II

TABLE OF STATUTES II

TABLE OF TREASURY REGULATIONS II

TABLE OF CASES.

Page

Affiliated Enterprises, Inc. v. Commissioner, 42 B. T. A. 390..... 2

Affiliated Enterprises, Inc. v. Gruber, 85 Fed. (2d) 958.....6, 9

M. E. Blatt Co. v. U. S., 305 U. S. 267, 59 S. Ct. 187.....4, 6

Burnet v. Hutchinson Coal Co., 64 Fed. (2d) 275, 12 A. F. T. R. 391..... 11

Commissioner v. Wilson, 76 Fed. (2d) 766, 15 A. F. T. R. 1228..... 11

Duffy v. Central Railroad Co., 268 U. S 55, 45 S. Ct. 429, 69 L. Ed. 846.....4, 6

Maass, Ex. v. Collector, 61 S. Ct. 631..... 14

Sanford Estate, 308 U. S. 89, 34 L. Ed. 20..... 14

TABLE OF STATUTES.

Revenue Act of 1934, C. 277, 48 Stat. 680, Sec. 351-1..... 7

28 U. S. C. A. Sec. 347..... 7

26 U. S. C. A. Sec. 641..... 7

TABLE OF TREASURY REGULATIONS.

Treasury Regulations 86 Art. 351-2 (1)..... 4

Supreme Court of the United States

OCTOBER TERM, 1941.

No.——

AFFILIATED ENTERPRISES, INC., PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

SUMMARY STATEMENT OF MATTER INVOLVED.

The respondent here was the petitioner below and will be referred to hereafter as the Commissioner. The petitioner here was the respondent below and will be referred to hereafter as the taxpayer.

This case involves the construction of the word "royalties" in the personal holding company statute, designated as Section 351-1 of the Revenue Acts of 1934 and 1936, and of the word "rents" and the words "other like property" in the Regulations promulgated pursuant thereto.

The applicable portion of said Section 351-1 in the Act of 1934, C. 277, 48 Stat. 680 (the Act of 1936 being the same in this connection), reads as follows:

> "The term 'personal holding company' means any corporation * * * if (A) at least 80 per centum of its gross income for the taxable year is derived from royalties, dividends, interest, annuities, and * * * (B) at any time during the last half of the taxable year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals" (R. 95).

More than 50% of the outstanding stock of the taxpayer was owned by not more than five persons during the taxable years in question.

The Commissioner having proposed a deficiency under said Section 351 against the taxpayer as a personal holding company for the years 1934, 1935 and 1936, on the ground that the taxpayer's income was from "royalties" as used in said personal holding company statute, the taxpayer filed its petition before the Board of Tax Appeals, which, on July 19, 1940, held that the taxpayer's income was not from royalties and that it was not subject to said Section 351, in Affiliated Enterprises, Inc. v. Commissioner, 42 B. T. A. 390 (R. 69).

The Commissioner then filed a petition for review with the United States Circuit Court of Appeals of the Tenth Circuit, which, by a majority decision, with one judge filing a written dissenting opinion, reversed the decision of the Board of Tax Appeals on November 11, 1941 (R. 94).

A petition for rehearing was filed December 8, 1941 (R. 113), and denied December 16, 1941 (R. 114).

The taxpayer was incorporated November 16, 1933, "for the purpose of promoting the use by theaters throughout the United States" (R. 17) of a system of free giveaways, operated under the name of Bank Night in most localities, but also operated under the name of Prosperity Night, Bank Day or Cash Night in other localities where those names were more suitable.

The taxpayer, during the years 1934, 1935 and 1936, involved here, entered into written agreements with theater owners whereby each theater owner agreed to pay to the

taxpayer a stated weekly sum for each theater, which was as low as $5 per theater in some instances and as high as $10 per theater in other instances (R. 11, 20).

In return for said weekly payment, the taxpayer furnished the theater owner for each theater an initial set of supplies, and thereafter gave advice and consultation as to the method of using the system in the locality involved and at its expense provided legal defense against lottery charges, if any (R. 20). Additional supplies were furnished at agreed prices (R. 20). The supplies included register books, record books and tickets, which were not copyrighted, and film trailers, some of which were copyrighted February 19, 1934, but not used after September 1, 1934 (R. 20). The only copyrighted articles used during the three years in question were instruction sheets, which described the method of using the system and were delivered to the theater manager for the purpose of acquainting him therewith. Said copyrighted sheets were not exhibited to the public. Applications to patent the system were denied (R. 21).

The method of operating the system could be learned by attending a theater using the system, and from the outset it was generally contended by theater owners throughout the United States that the taxpayer did not have the exclusive right to the use of said system (R. 19).

For this reason, these agreements were for stated weekly amounts, and were not based upon the substantial increased profits which resulted from the use by the theaters of said system, supplies and services (R. 19).

The taxpayer contended before the Circuit Court, as it had before the Board of Tax Appeals, which sustained said contention, that the taxpayer's income was from "rents," because approximately 86% of the taxpayer's income in 1934, 95% thereof in 1935 and 98% thereof in 1936, had been received from uniform weekly payments made by theatre owners in stated amounts without reference to the extent of use of the system, supplies, services, etc., provided by the taxpayer, nor the amount of income received by the theater as a result thereof (R. 25).

This contention was based upon two decisions of this Honorable Court which have been followed uniformly in

departmental decisions pertaining to personal holding company income, namely:

Duffy v. Central Railroad Company, 268 U. S. 55, 45 S. Ct. 429, 5 A. F. T. R. 5377, decided in 1925, in which this Court said:

> "The term 'rentals,' since there is nothing to indicate the contrary must be taken in its usual and ordinary sense, that is, as implying a fixed sum or property amounting to a fixed sum, to be paid at stated times for the use of property."

Thereafter, on December 5, 1938, in M. E. Blatt Company v. U. S., 305 U. S. 267, 59 S. Ct. 187, 21 A. F. T. R. 1007, this Honorable Court said:

> "Rent is a 'fixed sum or property amounting to a fixed sum, to be paid at stated times for the use of property * * *. It does not include payments uncertain both as to amount and time made for the cost of improvements * * *.'"

Although the Circuit Court recognized that the taxpayer essentially was an operating company engaged in promoting the use of an advertising system throughout the United States, and that the taxpayer had no income from royalties as such, nevertheless, the Circuit Court held that the taxpayer had a property right in said system (R. 97), and was subject to the personal holding company statute upon the ground that its income was included in the words "other like property" (R. 99), contained in the following extract from Treasury Regulations 86, Art. 351-2, (1) promulgated under the Revenue Act of 1934 defining royalties:

> "(1) Royalties.—The term 'royalties' includes amounts received for the use of or for the privilege of using patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property. It does not include rents, nor overriding royalties received by an operating company. As used in this paragraph, the term 'overriding royalties' means amounts received from a sublessee by the operating company which originally leased and developed the natural resource property in respect of which such overriding royalties are paid."

Substantially the same provisions are contained in Article 351-2 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, insofar as material in this case.

This inclusion by the Circuit Court of the taxpayer's income in the words "other like property" in the Regulations was made without reference by the Circuit Court to the fact that "rents" are excluded from personal holding company income in said Regulations, because of the refusal by Congress to include "rents" in personal holding company income, in order that operating companies might not be affected by the personal holding company statute.

This is a petition for a writ of certiorari to review the above opinion of the United States Circuit Court of Appeals for the Tenth Circuit.

REASONS RELIED UPON FOR THE ALLOWANCE OF THE WRIT.

1. This case presents questions of the first importance relating to the meaning of the word "royalties" in the personal holding company statute and the meaning of the word "rents" and the words "other like property" in the regulations promulgated pursuant thereto, which have not heretofore been passed upon by this Court.

An early authoritative decision of these questions by this Court is of pressing importance, not only to the parties to this cause, but also to many companies engaged in the oil industry and the mining industry, having not more than five stockholders, who have relied upon the decisions of this Court with reference to the definition of rentals, and departmental rulings based thereon in allocating their income for income tax purposes.

2. Aside from the novelty and importance of the issues presented, the opinion below should be reviewed for the additional reason, we submit, that it is clearly erroneous and not in accord with the principles of applicable decisions of this Court.

To the extent that the opinion below designates stated

payments to be "royalties," said opinion is not in accord with the decisions of this Court in the following cases:

Duffy v. Central Railroad Company, 268 U. S. 55, 45 S. Ct. 429, 5 A. F. T. R. 5377, decided in 1925.

M. E. Blatt Company v. U. S., 59 S. Ct. 187, 305 U. S. 267, 21 A. F. T. R. 1007, decided December 5, 1938.

3. In addition to the foregoing reasons, the opinion below should be reviewed because, in holding that the taxpayer had a property right in said system, said opinion is in conflict with the opinion of the United States Circuit Court of Appeals for the First Circuit in Affiliated Enterprises, Inc. v. Gruber, 85 Fed. (2d) 958, wherein it was held that the taxpayer had no property right therein after the first disclosure thereof, because a system of doing business cannot be patented and is not subject to protection by copyrights or trade-marks.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Tenth Circuit, commanding that court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a transcript of the record and proceedings herein; and that the decree of the United States Circuit Court of Appeals for the Tenth Circuit be reversed by this Honorable Court, and your petitioner have such other and further relief in the premises as to this Honorable Court may seem meet and just.

ALBERT J. GOULD,
Attorney for Petitioner.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

Opinion of Circuit Court.

The opinion in the Circuit Court (R. 94), dated November 11, 1941, has not been printed in the Official Fed. (2nd) Reporter.

II.

Grounds of Jurisdiction.

(A) Jurisdiction is invoked under 28 U. S. C. A., Section 347, and 26 U. S. C. A., Section 641.

(B) The statute involved is the Revenue Act of 1934, C. 277, 48 Stat. 680, Sec. 351. The applicable part thereof reads as follows:

> "Sec. 351. SURTAX ON PERSONAL HOLDING COMPANIES. (a) IMPOSITION OF TAX.—There shall be levied, collected, and paid, for each taxable year, upon the undistributed adjusted net income of every personal holding company a surtax equal to the sum of the following:
>
> (1) 30 per centum of the amount thereof not in excess of $100,000; plus
>
> (2) 40 per centum of the amount thereof in excess of $100,000.
>
> (b) DEFINITIONS.—As used in this title—
>
> (1) The term 'personal holding company' means any corporation (other than a corporation exempt from taxation under section 101, and other than a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, and other than a life insurance company or surety company) if (A) at least 80 per centum of its gross income for the taxable year is derived from royalties, dividends, interest, annuities and (except in the case of regular dealers in stock or securities) gains from

> the sale of stock or securities, and (B) at any time during the last half of the taxable year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals * * *."

The Regulations involved promulgated pursuant to the above statute are Treasury Regulations No. 86 promulgated under the Revenue Act of 1934. The applicable part thereof defining "royalties" reads as follows:

> "Art 351-2, (1) * * *. (2) Royalties.—The term 'royalties' includes amounts received for the use of or for the privilege of using patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property. It does not include rents, nor overriding royalties received by an operating company. As used in this paragraph, the term 'overriding royalties' means amounts received from a sublessee by the operating company which originally leased and developed the natural resource property in respect of which such overriding royalties are paid."

The applicable parts of the Revenue Act of 1936 (Sec. 351, C. 690, 49 Stat. 1648), and of the Regulations promulgated thereunder are not set forth because they are identical with the foregoing for our purposes.

DATE OF JUDGMENT.

(C) The date of the judgment sought to be reviewed is November 11, 1941 (R. 94). Petition for rehearing was denied December 16, 1941 (R. 114).

III.

Concise Statement of Case.

In the interest of brevity, we refer to the Summary Statement of Matter involved, contained in the Petition herein, which is sufficient for our purposes in lieu of restating the same at this point.

IV.

The Taxpayer Desires to Urge the Following Errors:

1. The majority opinion of the Circuit Court erred in not holding that the taxpayer's income was from rents.

2. The majority opinion of the Circuit Court erred in holding that "rents" may be included in computing personal holding company income under the words "other like property" in the regulations.

3. The majority opinion of the Circuit Court is in conflict with two decisions of this Honorable Court, namely, Duffy v. Central Railroad Company, supra, and M. E. Blatt Company v. U. S., supra.

4. The majority opinion of the Circuit Court erred in holding that the taxpayer had a property right in a system of doing business, and to this extent is in conflict with the opinion of the United States Circuit Court of Appeals for the First Circuit, in Affiliated Enterprises, Inc. v. Gruber, 85 Fed. (2nd) 958.

V.

ARGUMENT.

First, Second and Third Assignments.

"Rents," after considerable discussion in Congress, were excluded from personal holding income in the 1934 and 1936 Acts, in order that operating companies might not be included unfairly under the personal holding company statute, which was aimed at penalizing incorporated pocketbooks. For this reason, rents specifically were stated to be excepted from personal holding company income in the above Regulations.

Practically all the taxpayer's income in each of the taxable years in question was from stated payments required to be made without reference to any other factor (R. 25), and constituted rents under the decisions of this Court and cannot be termed royalties under the words "other like property" in the Regulations, which also expressly except rent from personal holding company income.

We have quoted from the Duffy case, supra. On April 27, 1936, pursuant to a request for a ruling as to the distinction

between the terms "rentals" and "royalties" as used in an oil and gas lease owned by a corporation, in order to determine whether it was a personal holding company, IT 2970 was issued, which reads in part as follows:

> "The term 'rental' must be taken in its usual and ordinary sense, that is, as applying to a fixed sum to be paid at stated dates for the use of property. (Duffy v. Central Railroad Co. of New Jersey, 268 U. S. 55; Frank & Seder Co. v. Commissioner, 33 B. T. A. 476). It was said 'the word "royalty" as used in a gas lease generally refers to "a share of the product or profit reserved by the owner for permitting another to use the property."'
>
> "While it is apparent that the fixed annual payments of x dollars provided for in Article IV of the lease here in question are rents, * * *."

The Blatt case, supra, was decided by this Honorable Court on December 5, 1938, in which the Duffy case, supra, was cited with approval, with other cases from Rhode Island, Massachusetts, New York, Louisiana, and 2 Blackstone, page 41.

Thereafter, IT 3401 was issued in 1940, concerning the distinction between the terms "rentals" and "royalties" under an oil and gas lease in order to determine whether a taxpayer was a personal holding company. This decision and two General Counsel Memoranda referred to therein follow the Duffy and Blatt opinions. We quote from IT 3401, Prentice Hall, 1940, Sec. 66318, briefly as follows:

> "I. T. 3401—Personal holding company income—'receipts under oil and gas leases' held to be 'rents' * * *.
>
> "Advice is requested whether the M corporation complies with the gross income requirements for classifications as a personal holding company under the provisions of the Internal Revenue Code.
>
> "The underlying question is whether an item of income designated 'receipts under oil and gas leases' in the amount of x dollars, such item amounting to less than 50 per cent of the corporation's gross income, constitutes 'rents' within the purview of Section 502

(g) of the Internal Revenue Code. The reference to this item, which is contained in a lease reads, 'The lessee shall pay to the lessor as a rental therefor, the sum of one dollar ($1) per acre per year, commencing on date of execution hereof and payable semi-annually in advance.

* * * * * * * * *

"While the question of whether 'delay rentals' constitutes 'rents' as that term is used in Section 502 (g) of the Internal Revenue Code does not appear to have received the consideration of the courts, the Bureau has held that for Federal income tax purposes 'there is no distinction between the term "rent" in the sense in which that term ordinarily is used, and "delay rentals." ' (G. C. M. 11197, C. B. XII-1, 238 (1933).) In the consideration of this question, it is further stated in C. G. M. 11197, that:

"'* * * 'Rent is a fixed compensation paid for the use, possession, or interest in land or other property.

"'* * * 'Care must be taken to distinguish between rent and royalty in connection with gas and oil leases. Rent is the term applied to the privilege given to bore for gas and oil and for delay in beginning operations; while royalty is a certain percentage of the oil after it is found, or so much per gas well developed.'

"It is, accordingly, held that the item 'receipts under oil and gas leases' in the sum of x dollars constitutes 'rents' within the purview of Section 502 (g) of the Internal Revenue Code."

In Burnet v. Hutchinson Coal Co., 64 Fed. (2nd) 275, 12 A. F. T. R. 391, the Court held that the amount required to be paid on a coal lease, regardless of mining operations, although minimum royalties could be charged against said stated amount, was rental and not royalty, because it was required to be paid, even though the property might not be used. This case has been cited with approval in many later cases, among which are Commissioner v. Wilson, 76 Fed. (2nd) 766, 15 A. F. T. R. 1228.

We omit other cases to the same effect.

That all dictionaries, including Bouvier's Law Dictionary and Webster's International Dictionary, cited by the Circuit Court, are in accord with the foregoing definite distinction between rentals and royalties, is established by the following quotations therefrom:

> "Royalty. A payment reserved by the grantor of a patent, mining lease, etc., and payable proportionately to the use made of such right." Bouvier's Law Dictionary, 1928, p. 1078.
>
> "Rent. Some of the common law properties are that it must be a profit to the proprietor, CERTAIN in its character, or capable of being reduced to a certainty, issuing yearly, that is periodically, out of the thing granted, and NOT BE PART OF THE LAND or thing itself." Bouvier's Law Dictionary, 1928, p. 1047.
>
> "Rent is a CERTAIN and PERIODICAL payment or service made or rendered by the tenant of a corporeal hereditament and issuing out of (the property of) such hereditament." Encyclopedia Britannica, 11th Ed. Vol. XXIII, p. 102.
>
> "Rent. In law (a). A compensation or return made periodically, or fixed with reference to a period of time, for the possession and use of property of any kind." Century Dictionary & Encyclopedia, Vol. VI, p. 5078.

In view of the foregoing and the Duffy and Blatt decisions of this Court, the following conclusions necessarily follow:

If the respondent had contracted to lease a producing oil well at the rate of $5 per week, as here, its income would have been rentals under every decision of the Supreme Court of the United States, and the rulings of the Income Tax Unit, because fixed sums required to be paid at stated times are rentals.

If the respondent had contracted to lease a producing metal mine at the rate of $5 per week, as here, its income would have been rentals under all the authorities referred to above, because fixed sums required to be paid at stated times are rentals.

If the respondent had contracted to lease a valuable trade-mark at the rate of $5 per week, its income would have been rentals under all the authorities, because fixed sums required to be paid at stated times are rentals.

If the respondent had contracted to lease the right to publish a copyrighted book or other article, at the rate of $5 per week, as here, its income would have been rentals under all the above authorities, because fixed sums required to be paid at stated times are rentals.

If the respondent could have acquired the absolute ownership of the system by patent, copyright or trade-mark, its income still would have been from rentals because, under all the authorities, A FIXED SUM REQUIRED TO BE PAID AT STATED TIMES, WITHOUT REGARD TO USE, IS RENTAL.

In view of the fact, therefore, that practically all the income of the taxpayer was from fixed sums paid at stated times, the question of whether the taxpayer had any patents, copyrights or trade-marks is entirely immaterial in this case, unless all the established definitions of "rents" are to be ignored.

In spite of the Duffy and Blatt decisions, supra, and the intention of Congress that "rents" should not be included in personal holding income, and the other authorities which we have cited, and in spite of the fact that the Circuit Court recognized that the taxpayer's income was not royalty in its ordinary sense, nevertheless, the Circuit Court concluded that the taxpayer's income was subject to the personal holding company statute under the words "other like property" in the Regulations.

We respectfully submit that "rentals," which were intentionally excluded by Congress from the personal holding company statute, may not be reinstated therein by judicial construction under the words "other like property" contained in the Regulations, and yet this is the effect of the opinion of the lower Court.

The anomalous situation which has arisen here is further accentuated by the fact that the lower Court's majority opinion holds that, because the statute was reenacted, rents,

twice excluded by Congress, shall now be included under the words "other like property."

If this construction is to stand, flat rentals paid under oil leases and mining leases must be held to be royalties, contrary to decisions of this Court cited above and consistent departmental decisions based thereon.

Only confusion and an entire revision of these departmental rulings can result unless the Circuit Court opinion is reversed.

This is particularly true in view of the fact that all Revenue Acts and Regulations adopted pursuant thereto subsequent to the Acts involved here, have contained personal holding company terms similar to those involved here, the limits of which should be defined by this Honorable Court.

The situation is similar to that involved in Maass, Ex. v. Collector, decided by this Honorable Court on March 3, 1941, in which certiorari was granted, although there was no conflict between decisions of the Circuit Court of Appeals, "because of the importance of the question." There a regulation was abrogated because it was considered an unwarranted extension of the plain meaning of the statute.

Here, an ambiguous regulation has resulted in a Circuit Court opinion whereby rents have been reinstated in the personal holding company statute as applied to an active operating company contrary to the plain intention of Congress that operating companies should not be affected by the personal holding company statute unless clearly within the terms thereof. An ambiguous regulation is not binding upon the Courts, Sanford Estate, 308 U. S. 89, 34 L. Ed. 20, but in view of the Circuit Court opinion, it is apparent that this regulation now should be construed.

We respectfully submit that the writ should issue and this Honorable Court should define the meaning of the word "royalties" in the personal holding company statute and the meaning of the word "rents" and the words "other like property" in the Regulations.

Fourth Assignment.

The Circuit Court held that the taxpayer had a property right in its idea or system if it was new or novel (R. 97) and

cited, of its own motion, five cases, none of which sustained that position, and all of which hold that the idea not only must be new or novel, but must be *unknown,* and that after the first disclosure, the originator has no property right therein (R. 97).

This holding is in direct conflict with Affiliated Enterprises, Inc. v. Gruber, 86 Fed. (2nd) 958, in which the Court said:

> "As the system has not been copyrighted and being in no sense a writing, could not be (Constitution, Art. 1, Section 8 cl. 8; 17 U. S. C., Section 4; 17 U. S. C. A. Section 4) and has not been patented, if it could be, we are constrained to hold that, although plaintiff has expended time and money in originating and developing a system, IT HAS NO PROPERTY RIGHT THEREIN which has been appropriated by the defendants. While the plaintiff restricts operation under the system to its licensees, by its very nature, in order for it to operate, knowledge thereof must be thrown open to the public and any property right based upon secrecy was lost as early, at least, as the first public exhibition, and there was no surreptitious appropriation of knowledge of the system by the defendants. In this respect it differs from the case of Board of Trade v. Christie Grain & Stock Co., 198 U. S. 236, 25 S. Ct. 637, 49 L. Ed. 1031, and other like cases. The situation is analogous to that where an inventor of an unpatented machine licenses others to use it in a way disclosing the device to the public, in which case there is nothing to prevent the public from building and using it."

Said holding, also, not only is contrary to the weight of authority, but we have been able to find no authority to sustain it.

Respectfully submitted,

ALBERT J. GOULD,
1019 Midland Savings Building,
Denver, Colorado.
Attorney for Petitioner.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes and regulations involved	2
Statement	2
Argument	5
Conclusion	7
Appendix A	8
Appendix B	11

CITATIONS

Cases:	
Affiliated Enterprises v. *Gruber*, 86 F. (2d) 958	6
Fairchild v. *Gray*, 136 Misc. R. 704 (N. Y.)	7
Helvering v. *Wilshire Oil Co.*, 308 U. S. 90	6
Horner v. *Gas Co.*, 71 W. Va. 345	7
Lane-Wells Co. v. *Commissioner*, 43 B. T. A. 463	6
Maxwell v. *Faust Co., Inc.*, 90 Misc. R. 702 (N. Y.)	7
McGill v. *Holmes, Booth, & Haydens*, 48 App. Div. 628	6
Puritan Mills v. *Commissioner*, 43 B. T. A. 191	6
Simonds Rolling &c Co. v. *Pope Manuf. Co.*, 180 Mass. 393	7
Textile Mills Securities Corp. v. *Commissioner*, No. 34, present Term	6
Volk v. *Volk Mfg. Co.*, 126 Atl. 847	6
Statutes:	
Revenue Act of 1934, c. 277, 48 Stat. 680:	
Sec. 351 (U. S. C., Title 26, Sec. 331)	8
Revenue Act of 1936, c. 690, 49 Stat. 1648:	
Sec. 351	9
Miscellaneous:	
Black's Law Dictionary (Third Ed.)	7
Bouvier's Law Dictionary (Rawles Third Revision)	7
H. Rep. No. 1546, 75th Cong., 1st Sess., pp. 4, 6 (1939–1 Cum. Bull. (Part 2) 704)	11
S. Rep. No. 558, 73rd Cong., 2d Sess., p. 14 (1939–1 Cum. Bull. (Part 2) 586)	11
Treasury Regulations 86:	
Art. 351–2	9
Treasury Regulations 94:	
Art. 351–1	10
Art. 351–2	10

Miscellaneous—Continued **Page.**

Treasury Regulations 101; promulgated under the Revenue Act of 1938:
Art. 403–1 (3) 5

Treasury Regulations 103, promulgated under the Internal Revenue Code:
Sec. 19.502–1 (3) 6

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 873

AFFILIATED ENTERPRISES, INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 69–83) is reported at 42 B. T. A. 390. The opinion of the Circuit Court of Appeals (R. 94–102) is reported in 123 F. (2d) 665.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered November 11, 1941 (R. 102). The petition for writ of certiorari was filed on January 16, 1942. A petition for rehearing was filed December 8, 1941 (R. 103-113), and denied December 16, 1941 (R. 114). The jurisdiction of this Court rests on

Section 240 (a) of the Judicial Code, as amended by Act of February 13, 1925.

QUESTION PRESENTED

Whether petitioner was a "personal holding company" subject to the surtax imposed by Section 351 of the Revenue Acts of 1934 and 1936. This depends upon whether income received by it from certain licensing agreements with theatres were "royalties" within the meaning of Section 351.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations involved will be found in the Appendix A, *infra,* pp. 8–10.

STATEMENT

The facts as found by the Board of Tax Appeals may be stated as follows (R. 70–77):

The petitioner was incorporated on November 16, 1933, for the purpose of promoting a system of giving away money prizes by lot in places of entertainment and operated under several names, but the one most commonly used was "Bank Night" (R. 70). During the taxable years, petitioner was engaged in a nation-wide business of promoting and vending the use of its system, which was offered to theatre operators as a method of advertising to increase patronage (R. 75). Petitioner's stock was owned first by three persons and later by five persons (R. 70).

Petitioner leased the use of its system for money consideration under written agreement called Bank Night license agreements. The printed form

of agreement recites that the petitioner is the owner of the copyrighted name "Bank Night," and of certain copyrights and patent pending of certain cards, register, film trailers, record books, and other accessories to be used in staging Bank Night. The second party is called a licensee, and the agreement recites that the licensee desires to acquire a limited license to use Bank Night in its theatre. The petitioner reserves the right to defend in the name of the licensee any court proceeding against the licensee attacking its right to exercise the license granted by the agreement. The licensee acknowledges petitioner's ownership of trade-marks, copyrights and patent pending, and also acknowledges that it is paying only for the rights that the petitioner may have in the things mentioned (R. 72).

In a majority of the agreements executed by petitioner, the consideration for the use of the system was from $5 to $10 a week and was not based upon the substantial increased profits which resulted from the use of the system (R. 72).

In connection with the use of the system, petitioner supplied the required materials and gave advice and instructions as to the way to use the system in different localities. Initial supplies, which cost petitioner $15 per theatre, were furnished without extra charge, but additional supplies were sold at a small profit by petitioner at agreed prices (R. 72–73).

In carrying on this business, the petitioner had distributors in key cities of the United States who

obtained the license agreements and enforced compliance with the "Bank Night" instructions (R. 74).

Petitioner has never owned a patent on its Affiliated System. Yaeger made application, on November 21, 1933, for a patent on "Means for Conducting Prize Drawings," but it was rejected on January 16, 1934. An amendment to the application was rejected on April 11, 1935. Petitioner made applications for patent in 1937 and 1938, which were rejected in the same years on the holding that "the art cited is unpatentable." The period for appeal from these rejections has expired (R. 73).

Petitioner filed applications in most states to register the name as a trade-mark applying to a system of "free give-aways" (R. 73).

Petitioner obtained copyrights on certain film trailers, instruction sheets which described the method of operating the system, and special notice stating that Bank Night is an advertising system. These copyrights were obtained in 1933, 1934, and 1935. The copyrighted materials were used for various lengths of time in the taxable years until substitutes were copyrighted. After September 1, 1934, no attempt was made to copyright trailers (R. 73).

The gross income of the petitioner from its licensing agreements amounted to 80% of its total income (R. 82) and increased from $100,028.93 in 1934 to $755,573.37 in 1936 (R. 74).

The Board held the income received from such agreements did not constitute "royalties" and therefore ruled that the petitioner was not a "personal holding company" within the meaning of Section 351 (b) of the Revenue Acts of 1934 and 1936 (R. 82–83). The Circuit Court of Appeals reversed (R. 102).

ARGUMENT

This case was correctly decided by the court below in accordance with applicable Treasury regulations, and does not present any conflict of decisions.

The only question involved is whether the petitioner received 80% of its gross income from "royalties," so as to render it a "personal holding company" within the meaning of Section 351 of the Revenue Acts of 1934 and 1936 (Appendix, *infra,* pp. 8–9) and subject it to the surtax imposed therein.

Article 351–2 of Regulations 86, promulgated under the Revenue Act of 1934 (Appendix, *infra,* pp. 9–10) defines royalties as including amounts received for the use of:

> * * * patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and *other like property.* [Italics supplied.]

This definition has appeared in all subsequent regulations. See Article 351–2 of Regulations 94, Article 403–1 (3) of Regulations 101 and Section

19.502–1 (3) of Regulations 103. Such administrative construction must be given effect unless contrary to the statute. Cf. *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90, 102–103; *Textile Mills Securities Corp.* v. *Commissioner*, No. 34, present Term. That the definition correctly interprets the statute is confirmed by decisions holding that income resulting from the use of an idea or article not covered by a patent may properly be called a "royalty." *Lane-Wells Co.* v. *Commissioner*, 43 B. T. A. 463; *Volk* v. *Volk Mfg. Co.*, 126 Atl. 847, 849; *McGill* v. *Holmes, Booth, & Haydens*, 48 App. Div. 628 (N. Y.); cf. *Puritan Mills* v. *Commissioner*, 43 B. T. A. 191.

True, petitioner did not have standing to maintain infringement suits against those who used its ideas without compensation, since it had no *exclusive* right in the system after it had become known. *Affiliated Enterprises* v. *Gruber*, 86 F. (2d) 958 (C. C. A. 1st). But its contracts with the licensees were nevertheless intangible property rights which gave rise to recurring payments similar to income received from the use of patents, copyrights, etc., and the general term "royalties" should be construed so as to embrace such payments.

Nor is it important that petitioner received recurring *fixed* amounts from its licensees.[1] The in-

[1] Although the term "royalty" is frequently employed to denote a varying amount reserved by a grantor for the use of his property, measured by the extent of use, fixed royalties are

come was doubtless made payable in this manner because of the difficulty in determining what proportion of the profits of the licensees would be attributable to petitioner's system.

These payments were not "rents," which were excluded from Section 351. The term "rent" generally refers to the return received for the use of corporeal property,[2] and in explaining why rents were excluded from Section 351 the reports of the Congressional committees indicate that the term "rents," although treated very broadly, was nevertheless considered in its commonly understood sense. See Appendix B, *infra*, p. 11.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
J. LOUIS MONARCH,
LOUISE FOSTER,
Special Assistants to the Attorney General.

FEBRUARY 1942.

---

also familiar in the business world, witness the well-known preproduction bonus or advance royalty in the oil business. See also *Horner* v. *Gas Co.*, 71 W. Va. 345; *Maxwell* v. *Faust Co., Inc.*, 90 Misc. R. 702 (N. Y.); *Simonds Rolling &c Co.* v. *Pope Manuf. Co.*, 180 Mass. 393.

[2] See Bouvier's Dictionary (Rawles 3rd Revision); Black's Dictionary (3rd Edition); *Fairchild* v. *Gray*, 136 Misc. R. 704 (N. Y.).

APPENDIX A

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 351. *SURTAX ON PERSONAL HOLDING COMPANIES.*

(a) *Imposition of Tax.*—There shall be levied, collected, and paid, for each taxable year, upon the undistributed adjusted net income of every personal holding company a surtax equal to the sum of the following:

(1) 30 per centum of the amount thereof not in excess of $100,000; plus

(2) 40 per centum of the amount thereof in excess of $100,000.

(b) *Definitions.*—As used in this title—

(1) The term "personal holding company" means any corporation (other than a corporation exempt from taxation under section 101, and other than a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, and other than a life-insurance company or surety company) if—(A) at least 80 per centum of its gross income for the taxable year is derived from royalties, dividends, interest, annuities, and (except in the case of regular dealers in stock or securities) gains from the sale of stock or securities, and (B) at any time during the last half of the taxable year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals. For the purpose of determining the ownership of stock in a personal holding company—(C) stock

> owned, directly or indirectly, by a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries; (D) an individual shall be considered as owning, to the exclusion of any other individual, the stock owned, directly or indirectly, by his family, and this rule shall be applied in such manner as to produce the smallest possible number of individuals owning, directly or indirectly, more than 50 per centum in value of the outstanding stock; and (E) the family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants (U. S. C., Title 26, Sec. 331).

Substantially the same provisions are contained in Section 351 of the Revenue Act of 1936, c. 690, 49 Stat. 1648.

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

> ART. 351–2. *Classification of a personal holding company.*—
>
> * * * * *
>
> It is the nature of the gross income and the ownership of the outstanding stock which determine the classification as a personal holding company, and the several conditions with respect to both must be satisfied to bring a corporation within the classification. Gross income must be determined for the entire taxable year and the ownership of the stock outstanding must be determined according to its ownership at any time during the last half of the taxable year. * * *

From the standpoint of the nature of the gross income, a corporation comes within the definition of a personal holding company for any taxable year when 80 percent or more of its gross income for such taxable year was derived from the following sources:

(1) *Royalties.*—The term "royalties" includes amounts received for the use of or for the privilege of using patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property. It does not include rents, nor overriding royalties received by an operating company. As used in this paragraph the term "overriding royalties" means amounts received from a sublessee by the operating company which originally leased and developed the natural resource property in respect of which such overriding royalties are paid.

* * * * *

Substantially the same provisions are contained in Articles 351–1 and 351–2 of Treasury Regulations 94, promulgated under the Revenue Act of 1936.

APPENDIX B

S. Rep. No. 558, 73rd Cong., 2d Sess., p. 14 (on Revenue Act of 1934) (1939–1 Cum. Bull. (Part 2) 586, 596).

> The House bill includes in the income within the 80 percent clause income from "rents." A great part of *real estate business* is done by small family corporations. These partake more of the nature of operating companies than mere holding companies. Your committee is of the opinion that it is unwise to include such companies within the category of personal holding companies. Therefore, the word "rents" is omitted from the definition. [Italics supplied.]

H. Rep. No. 1546, 75th Cong., 1st Sess., pp. 4, 6 (on Revenue Act of 1937) (1939–1 Cum. Bull. (Part 2) 704, 706, 708).

> Subsection (a) includes as items of personal holding company income "dividends, interest, royalties, and annuities." These items are the same as those used for the purpose of the 80 per cent test under existing law. "Royalties" as used herein has the same meaning [Revenue Act of 1936] as in the case of royalties referred to in section 351 of existing law and, therefore, includes income from copyrights.
>
> * * * * *
>
> Subsection (g) includes as personal holding company income, rents which do not constitute 50 per cent or more of the gross income. * * * Under existing law, rents

are excluded from the 80 per cent classification. This was done principally so as not to interfere with bona fide and legitimate operating companies whose business consisted *of the ownership and operation of office buildings, apartment houses, etc.* * * * On the other hand, it will protect the bona fide *real estate corporation* and other corporations renting property and deriving 50 per cent or more of their gross income from rents. "Rents" as here used is defined in its broadest sense and includes such items as charter fees, etc., and is not limited to rent of real property. [Italics supplied.]

U. S. GOVERNMENT PRINTING OFFICE: 1943